DOW THEORY LETTERS INC.

RICHARD RUSSELL
P.O. Box 1759
La Jolla, Calif. 92037

36 Letters per Year – $75 Annually

Registered with the Securities Exchange Commission

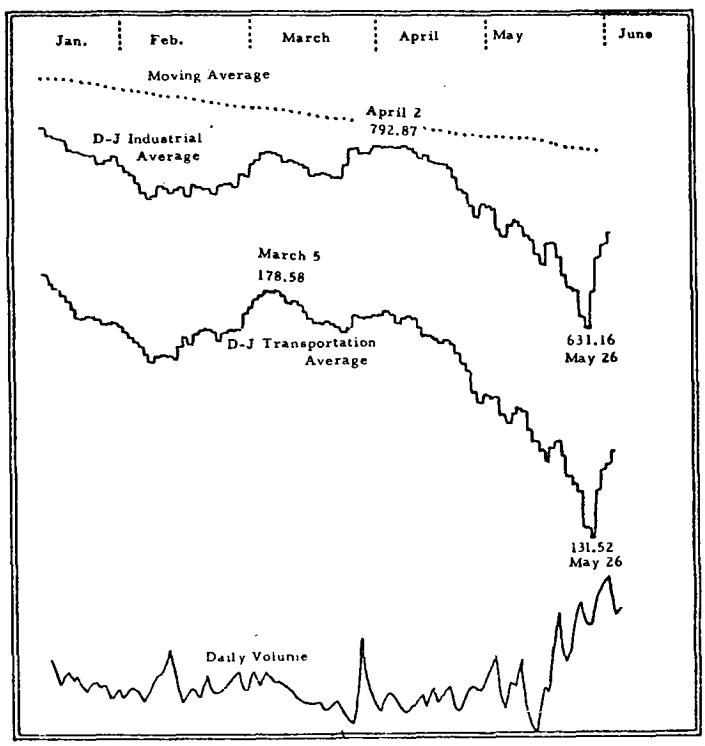
June 3, 1970 Letter 463

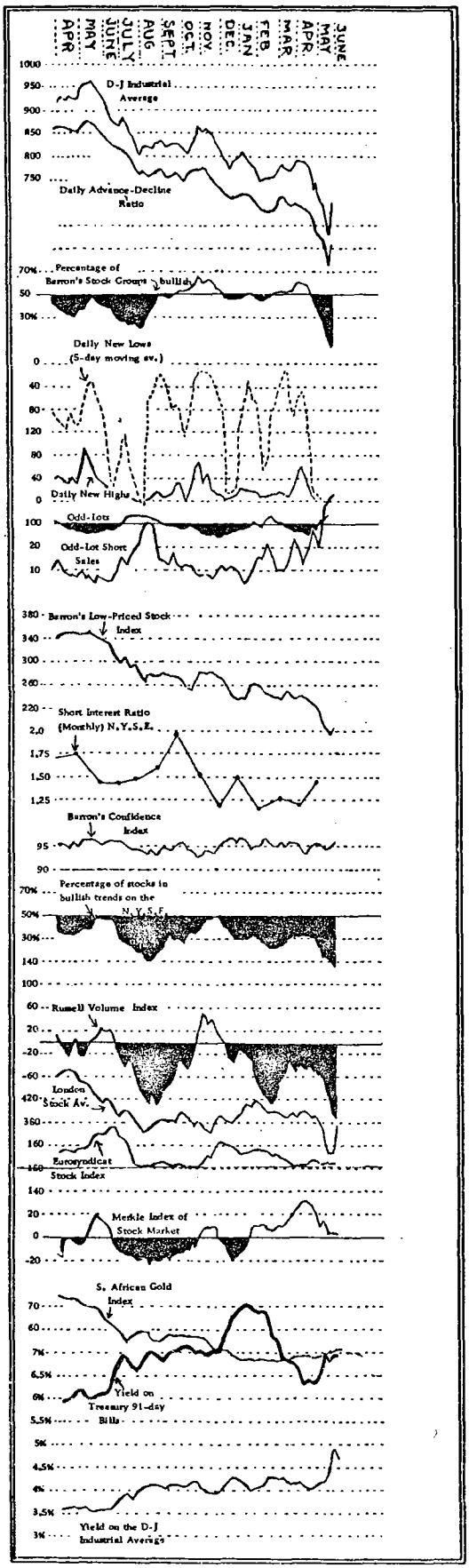
THE MARKET: On April 2, at the last rally peak, the Industrial Average stood at 792.87. On March 5, at their last rally peak, the Transportation Average closed at 178.58. What occurred after that represented one of the worst drops in market history. By May 26 the Industrials had fallen to 631.16, a loss of 21% in approximately eight weeks. On the same day (May 26) the Transportation Average closed at 131.52, a loss of 26% in a little less than three months. The intensity and severity of the decline was extraordinary, and it established a record in the breadth figures. On May 26 I blinked as I saw my 10-day average of daily declines rise above 10,000 for the first times since I have kept records of this indicator. The figure of 10,576 meant that the average of declines on the N.Y.S.E. for 10 days running was over 1000 each day. I have never seen that before.

In the last Letter (462) I noted in a study of the Dow and its moving average that the Dow had not dropped farther than 15% below its moving average since the bear market began. All that changed during May. At the May 26 low of 631.16 the Dow had plunged 20% below its moving average. This indicated conditions which, if heavy volume had accompanied the move, would have appeared like crash-action. It was beyond doubt the worst break since the bear market started.

On May 27 the market rebounded violently with the Dow up 32.04 points for the day. May 28 and 29 saw a follow up of the rally on expanding volume as the Dow closed up 20.95 points and 16.29 points respectively. As had happened during every rally of the past 18 months, hopes were rekindled, and opinions were expressed to the effect that "This could be a new bull market".

Bear market rallies (particularly after violent primary declines) tend to be explosive and on high volume. Personally, I would be much more impressed if the rally were slow and "labored", and accompanied by steady or declining





 volume. A 69 point rise in three days on the highest volume of the year is hardly the kind of action which heralds in a new bull market. It is a reaction to the smash which preceded, and as such is "normal" corrective action for this bear market.

I will repeat again that "People tend to believe what they want to believe". This bear market has brought on tragic losses, and everyone wishes it were over. Wishing will not make it so. After a 20% drop in the Dow in an eight-week period, we are entitled to a violent rally. Movements counter to the primary trend are usually much sharper than the movements with the trend. This counter-trend correction in a primary bear market is no exception. It is explosive and therefore "impressive" to the neophyte.

I want to warn subscribers again that bear markets are made to separate stockholders from their money. And the more "real" the appearance of a rally, the better chance the bear market has to keep those with losses hoping, and those who are perpetually optimistic buying. Just as a bull market stays healthy by providing periodic corrections and "shake-outs", so a bear market stays strong by producing sharp, crowd-pleasing rallies.

This bear market is, in my opinion, fated to last much longer and probe much lower than anything we have seen so far. After all, if the decline continued at the April-May rate, the Dow would have reached zero by the end of the year! Thus I continue to advise my subscribers to let the "investors", the scalpers, the in-and-out traders and short sellers have their innings with this treacherous market. In the end, the bear will entice 90% of the players into its lair, and ultimately the forces of the primary bear trend will have produced losses far beyond what anyone now believes possible.

I have been asked whether I think the second phase of the bear market ended on May 26 at 631.16 for the Dow. Personally, I do not think so, but it will take more time for me to draw a firm conclusion on that one. Actually, from the standpoint of investment strategy, I do not think it matters. For even if the second phase has ended, we are going to end up with a third phase. That is the true liquidation phase. I believe that the third or final phase of this bear market will be the most drastic and tragic of any of the three phases. And just as the 1957-66 third phase of the bull market was the longest and most violent, I have a suspicion that the third phase of this bear market is going to match the bull market's third phase (i.e., 1958 to 1966), but in reverse.

TRACK OF THE BEAR: The losses on common stocks since January, 1969, have approached $300 billion dollars. The losses in bonds are almost $50 billion. On a per capita basis, it is estimated that each of America's 26 million stockholders has lost about $10,000. During all 1929 to 1932, it is estimated that $85 billion in stock values were erased. In 1932 the GNP was $103 billion, in 1969 it was $933 billion. On a comparison basis with GNP, you might say that the situation is about 40% as bad as it was in 1932. Or that it would take total market losses of $765 billion to approximate 1932.

In 1929 there were about 120 million people in the nation, today there are over 200 million. It is believed that there are about 20 times as many stockholders today as there were in 1929. This means that the current bear market is affecting far more people now than in 1929.

The bull market of 1949 to 1966 took the Dow from 161.60 to 995.15, a gain of 834 points. The current primary bear market is in the process of correcting that 834 point rise. As of last week, the Dow had dropped from 995.15 to a low of roughly 635, a loss of 360 points. This means that 43% of all the Dow gains of 1949 to 1966 have now been erased. Most of this occurred within a year and one-half. It's been one of the most vicious collapses on record.

A N.Y.S.E. seat sold last week for $170 thousand, down from 1968's high of $515,000. This represents a loss of two-thirds. I have heard people say that floor members "clean-up" during a bear market. They couldn't be more mistaken.

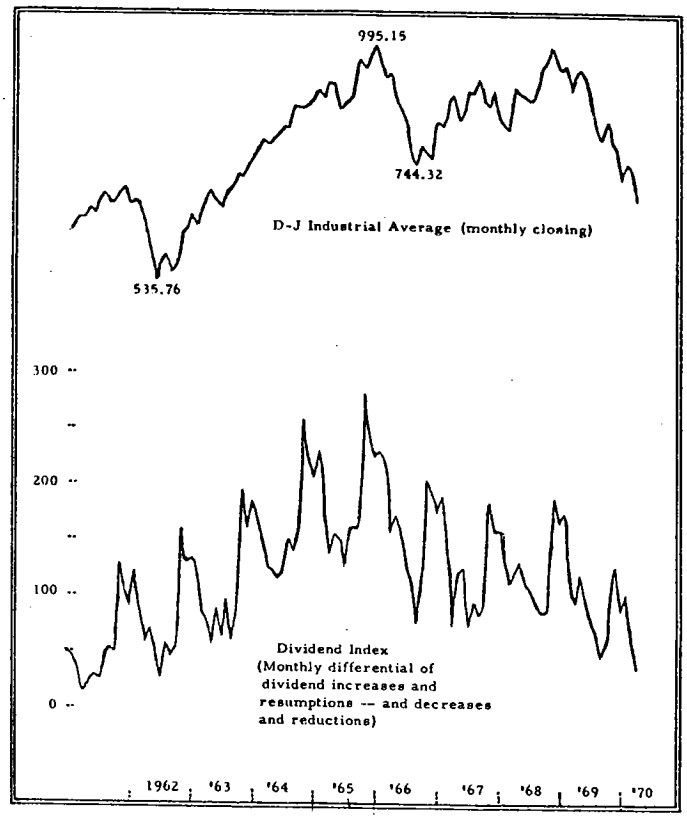
Last week I received a letter from Bill Gordon with his April-May computation on the Dow short interest. The figures show a 25% (!) drop in the total short interest in the 30 Dow stocks, from 651,000 to 486,000. The Dow short interest ratio dropped from a low .87 in April to a frighteningly low .57 in May (see Letter 461). If everyone is so bearish, I ask myself, where are the shorts? They may be shorting something, but it isn't issues on the N.Y.S.E. Prognosis, ominously bearish.

Last week the House Ways & Means Committee estimated that the Federal deficit would be $9.2 billion for fiscal 1971, $4.5 billion if new revenue bills are passed. The Administration asked a boost in the national debt, up $16 billion to $395 billion. I might add that my own guess for the budget deficit, in the face of what I think will be collapsing corporate profits, is nearer $20 billion than $4.5 billion.

In the face of these frightening budgetary prospects, the bond market crumbled anew with the bellwether Treasury 4¼ bonds of 1987-92 sinking to an incredible 63 bid, at which price these bonds yield 7.45%. Thus the longest-term, highest coupon bonds of the U.S. Government are now selling at 63¢ on the dollar. At the same time, the D-J 40-Bond Average sank to a 38-year low of 67.71, just two points above the record low of 65.78 struck in 1932. At the 1932 price of 65.78, the very solvency of the

nation was in question. Adding their voice to the disaster, the Municipal bond average's yield rose above 7% last week, for the first time in history.

DIVIDENDS: A great deal of nonsense has been written about dividends, perhaps as much nonsense as about any other segment of the market. Dividends (despite what they tell you) are important. Dividends represent the return to the investor on his equity money, which is one of the things ownership of securities is all about. An investor may buy a stock which is going up in value (increasing in price), but sooner or later there's got to be a pay-off, and that pay-off is a dividend.



Increased value and earning power always implies an ultimate pay-out in dividends, and no stock in history has continued to go up without an ultimate payout, regardless of its glamor or "potential".

The trend of a corporation's dividend, in general, represents the considered measure of its earning power, its success, and the judgement of its officers regarding its future. Taken in mass, the trend of dividend growth (or diminution) represents the judgment of thousands of corporate officers regarding the earning power of their own individual companies.

A few weeks ago I decided to go back and compute total dividend changes from the monthly statistics on thousands of corporations (issued by Standard & Poor). The study proved to be fascinating to me. I started with January, 1961. Each month S & P lists all dividend increases and resumptions plus extras. They also list dividend omissions and decreases. I decided to leave out extra, since these can often represent a "phoney" enticement, a one-shot, or a temporary bit of enthusiasm. I used dividend resumptions and dividend increases on one side — and dividend omissions and reductions on the other. It was the differential between these two which I charted.

The trend of total dividends is clear on the chart (the peaks represent year-end announcements, and the year-end is the place where most of the changes are likely to take place). I was most interested to see that the peak of the dividend trend occurred in November, 1965, at a differential of 288 in favor of resumptions and increases. That was three months prior to the bull market peak in February, 1966!

Since November, 1965, the trend of dividends is towards fewer resumptions and increases, more reductions and omissions. In fact, the differential in April, 1970, was only 36, the lowest figure since the 33 of March, 1961. During April of 1970 the number of dividends increases was 82, the lowest of any April since 1962. During April, 1970, there were 24 dividend decreases and 24 omissions. This is the highest number of decreases since November, 1962 and the most omissions since September, 1966.

If the trend of this chart continues, the implications are obvious. If the index drops below zero it will mean that cuts and omissions are beginning to outnumber increases and resumptions. At that point total dividend payouts for corporations will be on the wane, and the bear market will start eating into stockholders income (it has already shattered their assets).

Then the old saw, "Well, I'll hold it because it has always paid me such-and-such a dividend" will start to lose its validity. At that point, I expect the public to begin to turn ominously bearish on the stock market.

QUESTIONS & ANSWERS: The questions keep piling up here. I don't know if I can provide the answers, but I will provide my answers.

Q: How far down do you think this bear market is going?

A: We are now deep into the second psychological phase of this bear market. The downside potential for the second phase does not seem exhausted to me at this time. Volume on the downside has not been excessive, odd-lotters keep groping for the bottom by buying on balance, prices have remained "orderly" on the downside. No one seemed panicky to sell. It might not happen during the second phase (it could occur in the third phase), but I would guess that this second phase could bring on a panic in the stock market. That means large spreads between "bids" and "asked", high volume, confusion, very late tapes, etc.

After the second phase bottom, we should get a sub-standard rally. I believe it will be sub-standard because so much of the upward (corrective) potential for this bear market was used up in the huge 1966-68 counter-primary trend advance. I would guess that the upward correction separating the second from the third phase is going to be a "disappointment".

The third phase should be accompanied by disastrous liquidation. It could cut the Dow by as much as a third to a half, from wherever the third phase begins. It would not surprise me to see the final Dow lows in the 300 to 350 area or even lower (depending on social and political considerations at the time).

Q: Do you think we are going to have a full-fledged depression?

A: I know that there are only a tiny handful of people in the nation who agree with me, but I do think we are going into a depression, a major depression. The 1949-66 bull market saw the greatest mass of speculation, debt build-up and sheer fiscal folly in the nation's history. The private and public debt of this nation hit $1.7 trillion during 1969. Interest has to be paid on this debt, and some of the debt will have to be retired each year. The stock market is saying that earnings along with everything else are heading for a collapse. In the preceding section of this report I show what is happening to the trend of dividends. Unemployment is heading up. It is difficult to sell bonds, even at record yields. The nation has engaged in a debt and spending binge from which their is no exit except liquidation or massive inflation. Bonds began the liquidation. Stocks are following. The economy will be third.

I read over and over in magazines, newspapers and investment services that there can't be any depression. Why? Because our government stands committed to full employment and prosperity. I simply can't understand the logic of people who hold to this opinion. Our Government has been the biggest spender, the biggest debtor, the biggest fool of all. Yet it is the Government that is supposed to bail us out? With whose brains, with whose money, with whose know-how?

Q: If you are thinking this way, do you foresee a possible revolution?

A: There will be revolutions, but perhaps not the bloody kind. The nation is in ferment now, and some of the questions being asked are revolutionary. People are asking what we are getting for our $80 billion a year in defense spending, our $1.7 trillion debt, our wasteful and in many cases useless way of life, our de-humanized approach to ourselves, our neighbors and the rest of the world. Yes, there's going to be a revolution, but I can't say just how it's going to go. But you can be sure of one thing, crucial questions are going to be asked, the "dirty water" is going to seep out from under the closet door, and people are going to do some revolutionary thinking and acting. Facts and truth are going to be king during the next few years, and dreams and nonsense are going to go to the wall.

Q: Will you be recommending stocks at the final bear market bottom?

A: I'll probably be recommending my head off. The question is, will anybody believe me?

Q: What about real estate during the next few years as an inflation hedge?

A: First, inflation is nearing its end. The worry during the next three or four years is going to be deflation — and how to stop it. The stock and bond markets are going through one of the fastest and most vicious deflations in history. Prices of everything else should follow.

The real estate and land picture, to me, is one of the most flagrently inflated areas in the economy. Millions of houses and millions of acres of land are now held on a "shoe-string". People have been living high on the hog, in houses mortgaged to the banks, with little or no cash to back up those dream establishments. They are going to be in for a shock as they find their mortgage payments start eating them up, cutting increasingly into their declining income.

The first stage of the housing collapse will be stagnation of sales with prices holding. The second stage will be a sales increase with prices breaking badly. The last stage will be trying to get anyone to buy any house regardless of price. It's going to be a problem of getting people to spend money, or getting a bank to finance a house. And that's going to be tough in the period ahead.

As far as speculative land, I believe it is going through the wringer. Thousands of speculators have been sitting on acreage, waiting for the prices to rise and a bigger sucker to pay the fatter price. Once they see the value of their land collapsing, they are going to panic. I expect land prices to crumble during the next few years. Some time in the next four or five years, good land, well located, at a bargain price will again represent a great investment.

Q: What about art as an investment or holding?
A: If there is any area which is more inflated than land, it is art. Here again, I expect to see art prices smashed. I remember in 1949 when I could have bought a small Renoir for $800, a large Romney (who was out of "style") then for $500. Prices since then have increased 1000%, 2000% and more. People tell you there are only so many Renoir's or Mattisse's. That's true. But remember when they were saying that there was "a shortage of good stocks", and all you had to do was buy duPont and General Motors, "and put 'em away for the kids"?

What's happening now only occurs once in every one or two generations, but when it happens you can forget all the old slogans and cliches. We are heading into an economic smash together with panic and a liquidity crisis. Gold and the dollar (and I hope I'm right about the latter) are going to be king, together with hard currencies throughout the world. If the dollar runs into such problems that it is beyond redemption by devaluation, well you can figure there will be so many problems around that finances will not be what you are thinking about. In the meantime, I intend to operate on the thesis that the dollar (at some price in relation to gold) will stand.

Q: Should I buy Swiss francs or some other hard currency?
A: That's a risk (or hedge) and probably not a bad one. But a world depression is going to affect the Swiss too. Also, there could be exchange controls or blocked currency, and you could have all kinds of trouble getting hold of your Swiss francs when you need them. Personally, I have not purchased any foreign currency, but that doesn't mean that you shouldn't. A hedge is a hedge, not a sure thing, and I see nothing wrong with a hedge in a foreign currency.

Q: Will what's happening now affect the rest of the world?
A: Yes, it will affect the entire globe. True primary movements are always international in scope, but the strongest nations will probably be affected least. The communist countries will also be affected by the collapse, and from sources that I read there is little doubt that Russia is now in recession. Perhaps the biggest propaganda advantage going for Mother Russia (and China) right now is that they have no stock averages. If they did, I imagine it would resemble ours — or even look worse.

Q: What should I do with stock I have not sold?
A: This is the single question that annoys me most. A patient dying of an infection says to his doctor, "Doc, I didn't take the antibiotics you gave me. What do I do now. I'm sick as hell, and I don't know whether I'll see the light of dawn." What can the doctor say? Maybe he can say, "Take them now, you fool, and hope to God they'll still do some good."

Q: In the May 23 issue of NEWSWEEK their three top economists were interviewed on the economy and the market. Paul Samuelson said, "So the last half of 1970 should show a resumption of real growth — as both Washington and everybody else has expected." Henry Wallich stated, "The economy is on track, but a little behind schedule: the slowdown has been mild, and growth seems about to resume." Milton Friedman said, "I doubt that an upturn will come before the third or fourth quarter at the earliest. Meanwhile, the best bet is that the recession will continue rather mild." In view of what these and other outstanding men say about the future, what about your rather solitary view of collapse and depression?
A: At the Bankers' Convention last year, only 6% of the bankers polled thought the Dow would be under 750 by the end of 1970. The first four months of 1970 showed 94 out of every 100 of these leading bankers to be wrong. My first article in Barron's was written in early 1958, during the depths of the recession. I was talking about a boom, in the face of the worst gloom (up to that time) seen since World War II. Everybody and his brother told me I was crazy (except the Editor of Barron's, who had the courage to publish that article). They're probably saying the same thing today.

The experts tend to think in terms of "normal" action, and when they all think the same (which they are now doing) I feel that they are not thinking at all. Most of the experts don't understand the primary trend, and they don't comprehend mass psychology, and they don't understand a 180 degree reversal of the trend. They haven't studied history, and they don't realize that there are times when violent change is the order of the day.

I have seen times when 95% of the experts have been dead wrong. I believe that this is one of those times. The experts are now thinking in terms of 1953, 1957, 1960 and 1962, only "a little worse". In my opinion, they might as well be comparing a leak in the spigot with Niagra Falls.

Q: Should I hold my utility stocks? My broker says they are good defensive issues in a bear market.
A: My advise is to change brokers. Utility issues may hold up better than others in a bull market correction, but in a primary bear market they can bankrupt you the same as any other issues. Let's look at some figures. The worst bull market correction of the 1949-66 bull market, which was 1962, saw the D-J Utility Average drop from a high of 163 to a low of 103. This represented a loss of 24%, about the same as the Dow.

 Now let's take the primary bear markets. Perhaps 1929-32 isn't fair because that bear market saw the collapse of the utility pyramid-empires. At any rate, the Utility Average sank from a 1929 high of 144 to a 1932 low of 16, a loss of 88%, about the same as the Dow. The 1937-38 bear market saw Utilities drop from 39 to 15, a loss of 49%, or about the same as the Dow. The bear market of 1946 saw Utilities break from 43 at the high to a 1948 low of 31, a loss of 28%, which was worse than the Dow.

The 1965 bull market peak for the Utility Average was 163.32, touched on April 20. As of last week's reading of 98, Utilities had lost 65 points or 40%, which was worse than the Dow. On May 20, 1970, the Utility Average dropped almost unnoticed below its 1962 low of 103.11. In so doing, it had the dubious distinction of being the first of the D-J stock averages to break its 1962 low (1962 low for Industrials was 535.76, 1962 low for Rails was 114.86). And I guess that's all I have to say about Utilities. They don't hold up that well in a bull market reaction; in primary bear markets they go with everything else — and often worse.

Q: Well, what about bonds here?
A: This is a particularly unfortunate period for "havens". It is unfortunate in that this nation is moving into a liquidity crisis. Our Government, our corporations and our citizens have not yet gotten over the habit of spending more than they're earning— and borrowing the difference. As a result, the bond market is moving from shambles to chaos.

The general and classical theory is that when stocks collapse and recession takes over, everyone spends less, less money is needed, and bonds rally. And that's usually the way it goes. But this time the difference is that everyone is in hock up to and above their ears. Our corporations are beginning to face the fact that they will have to borrow to cover expenses, always a very dangerous game. Our Government is just waking up to the fact that the corporate profits are on the way down, way down, and tax receipts are going to be far under expectations. The choice, cut back drastically on expenses, borrow in the bond market to make up the deficit, or both.

Many feel that the Government will not want to cut back during an economic cave-in. That leaves the bond market to absorb the shock of massive new issues. The only trouble is that currently there isn't much of a bond market to speak of. It's what I term "the remains" of a bond market. Conclusion: For years people have been telling us that the Government won't let this or that happen. "Testing-time" for the U.S. Government has just about arrived.

Q: Won't the Federal Reserve try to pump up the money supply in the same manner as 1966-68, and won't this get us out of this economic and market fix?
A: Well, they're trying it right now. According to the Federal Reserve Bank of St. Louis' latest bulletin, Federal Reserve Credit is now expanding at an 11% rate as compared with a 5% rate in 1969. Thus the U.S. continues to handle its money like a Banana republic, putting the brakes on when people scream about inflation, pumping up the money supply when they scream about a stock market smash.

The "pump" approach is fraught with perhaps a greater danger than deflation. The international monetary front has been quiet for a while, but I do not expect this to last too much longer. As prices keep inflating and as it requires more and more dollars to buy an ounce of gold, we will be approaching the monetary panic point. Foreigners have been as complacent as everyone else regarding U.S. monetary policy, hoping month after month that some "miracle" would turn the U.S. Government "honest" about the dollar and their commitments and debts.

But honesty has played no part in the picture so far. And as the fall election nears, it is clear that President Nixon wants things on an even keel, with happiness spread all over in the usual thin layer. Can the 1966-68 miracle be repeated? Somehow, I doubt it. And even if it is repeated in some rough form, there is the ominous problem of corporate liquidity, which will hardly be helped by an attempt to stimulate spending to new heights.

I have mentioned before that each infusion of credit and inflation produces less in terms of solid, fundamental results in the U.S. economy. Meanwhile, it seems probable that the Administration will continue trying to solve its problems by kicking dead horses. For the life of me, however, I don't seem to remember reading about any dead horses who were brought to life by repeated kicks.

LATE NOTES: (Written Tuesday morning, June 2)... I am fascinated by the diminishing upside series being recorded by the Dow on this rally. May 27, Dow up 32.04 points, May 28, Dow up 20.95, May 29, Dow up 16.95, June 1, Dow up 9.92. This is a very rare type of upside corrective action, and the high day of the series could easily represent the "exhaustion level" on the upside for the Dow.